FULLERTON FUND MANAGEMENT

THE FULLERTON WEEKLY

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Emerging Market Jitters – No 'Taper Tantrum' Redux

Emerging markets (EM) slipped last week as steeper developed market bond yields and uncertainty leading up to the central bank meetings in Japan and the US weighed on investor sentiment. The sell-off prompted worries of a possible repeat of the 'taper tantrum' in May 2013, when the Fed first announced a tightening of monetary policy. EM bond fund flows registered the smallest reading since Brexit last week, at just US$34 million. EM equity inflows also moderated to US$755 million, from US$2.1 billion in the prior week.

Bond yields appear to have been driven higher on concerns that policymakers in the developed world are potentially re-assessing the limits of unprecedented quantitative easing (QE) measures. Indeed, markets have begun to question whether major DM central banks remain committed to continued large-scale asset purchases. Earlier this month, the European Central Bank disappointed markets when it did not signal the possibility of extra stimulus and left the tenure of its QE programme (which runs until March 2017) unchanged. The outcome of the Bank of Japan and the Federal Open Market Committee meetings happening this week will be therefore be closely watched.

In Japan, the Japanese Government Bond (JGB) curve has steepened recently. This reflects concerns of less long-end buying by the Bank of Japan (BOJ) in auctions, an explicit focus in BOJ governor Kuroda's speeches on bank profitability, and speculation of more flexible quantitative easing (QE) in the meeting on 21 September. The steepening of the JGB curve has also added to US curve steepening pressures, which weighed on EM sentiment. In the US, the mixed messages sent by various Federal Reserve officials have left markets perplexed on the Fed's policy framework and the timing of the next rate hike. Indeed, the market continues to price in a very shallow interest rate path, with only an 18% chance of a September rate hike and a 50% probability of a rate hike in December instead. Should the Fed surprise markets with a September rate hike, the knee-jerk reaction in markets could be negative as investors would need to digest the Fed's intentions.

Notwithstanding the market volatility that could persist in the near term, the investment case for emerging markets remains intact. In emerging Asia for example, many economies have generally reduced vulnerabilities (current accounts have improved and external debts are under control) and are better placed to withstand the vagaries of fund flows. From a valuation standpoint, EM continues to trade at a significant discount to DM, while EM's return on equity (ROE) has shown a notable improvement, and is now higher than the ROE of DM. More positively, earnings revisions across EMEA, Asia ex Japan and Latin America are improving, having turned upwards in March this year on the back of a weaker USD and rising commodity prices. In the absence of an increase in the oil price, a further rebound in growth is likely to be more selective. At the company level, we continue to focus on quality names that are able to organically expand market share, and which in turn affords them pricing power and the ability to enhance productivity/efficiency.

	Value	% wow Change
Equities		
Dow Jones Indus. Avg	18,123.8	+0.2
S&P 500 Index	2,139.2	+0.5
MSCI AC Asia Pacific	137.1	-2.3
S&P/ASX 200 Index	5,296.7	-0.8
Hang Seng Index[1]	23,335.6	-3.2
Ho Chi Minh Stock Index	651.3	-2.3
Jakarta Composite Index	5,267.8	-0.3
FTSE Bursa Malaysia KLCI[1]	1,653.0	-2.0
KOSPI Index[3]	1,999.4	-1.9
Karachi 100 Index	40,363.7	+0.1
S&P BSE Sensex Index	28,599.0	-0.7
Shanghai SE Composite[2]	3,002.8	-2.5
Stock Exch Of Thai Index	1,479.1	+2.3
Straits Times Index	2,827.5	-1.6
Taiwan TAIEX Index[2]	8,902.3	-2.9
TOPIX Index (Tokyo)	1,311.5	-2.4
Bonds / Currencies		
US 10YR Treasuries	1.6926	+2bps
EUR/USD	1.1155	-0.7
USD/JPY	102.29	-0.4
GBP/USD	1.3002	-2.0
Commodities		
Gold (Spot)	1,310.3	-1.3
Crude Oil (WTI)	43.0	-6.2
RJ/CRB Commodity Index	180.8	-1.0

Source: Bloomberg (last trading price for week ended 16 September 2016)

[1] As of 15 September 2016

[2] As of 14 September 2016

[3] As of 13 September 2016

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